RG050-3A

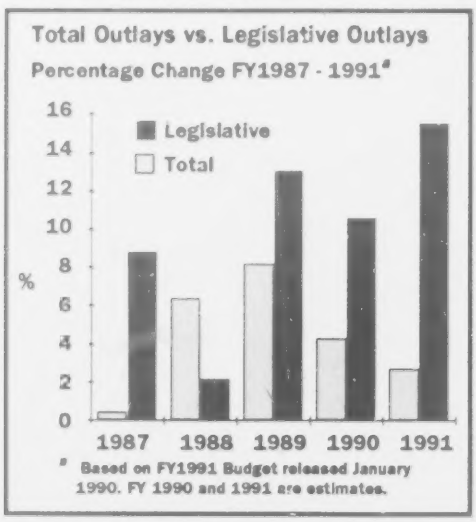
Tax Foundation Vol. 34, No. 3 March 1990

# Tax Features

## U.S. Congress Carries $2.3 Billion Price Tag in 1990

### Up 10.6 Percent Over 1989

Last year's failed Congressional pay raise was slam dunked nationwide with great fanfare, and the slightly less generous one enacted later just went into effect last month. But that raise is a drop in the bucket compared to the $2.3 billion taxpayers will pay to fund the operations of the nation's legislative body during fiscal year 1990.




Overall spending on the legislative branch is estimated to rise $222 million in FY1990, hitting an all-time high of over $2.3 billion. While total federal spending is estimated to increase 4.8 percent this year, legislative branch spending will increase more than twice as fast at 10.6 percent.

The cost of Congress itself, now over $1.1 billion, has risen a whopping 93 percent since 1980 and costs over six times more than it did in 1970. The Senate will run $385.3 million ($3.9 million per Senator), while the House will require $571.1 million ($1.3 million per Representative). Joint activities of the House and Senate will cost an additional $167 million.

Congress also maintains a number of legislative agencies, such as the Congressional

*See Cost of Congress on page 4*

FRONT BURNER

### Insure Social Security with A Tax Cut

*Sen. Daniel Patrick Moynihan*

On December 29, 1989, I announced, with little fanfare but some ensuing attention, that I would introduce on the first day of the second session a bill to cut Social Security contribution rates and return the system to pay-as-you-go financing.

The bill — which I introduced on January 23, 1990 — would strengthen the Social Security system, restore honesty and integrity to our federal finances, and provide a fair tax cut to 132 million Social Security taxpayers.

The Social Security tax rate increased on January 1 from 6.06 percent for employees and employers each to 6.2 percent — excluding the 1.45 percent rate for Medicare. The bill would repeal this rate increase retroactively, further cut the rate effective January 1, 1991, to 5.1 percent, and schedule future tax rate increases starting in 2012.

This would be a $62 billion tax cut for working people over two years. For a single person or a couple with combined earnings at the Social Security taxable maximum in 1991 (an estimated $54,300), the tax cut savings would be about $600 in that year alone. Savings in future years would be even greater.

At the same time, future Social Security benefits would be even more secure than they are under present law. The legislation would put Social Security on a sound current cost, or pay-as-you-go, financial basis that would keep the system solvent for the next 75 years — or 20 years longer than under the current arrangements.

I do not take this measure lightly, or without awareness of the complexity of the

*See Moynihan on page 2*

*Daniel Patrick Moynihan, a Democrat, is the senior U.S. Senator from New York.*

*Ed. Note: The Front Burner is a forum for participants in the fiscal arena to express their opinions on tax and budget issues. These opinions are not necessarily those of the Tax Foundation. Editorial replies are encouraged.*

Tax Foundation

IN THIS ISSUE


| | |
|---|---|
| Cost of Congress | 1 |
| "Front Burner" | 1 |
| Foreign Investment Hearings | 3 |
| Commissioner King on Social Security | 5 |
| R&D Seminar | 6 |

*Moynihan from page 1*

matter. To the contrary, at the beginning of last year I made it quite explicit that this option might have to be chosen.

Specifically, the report of the Democratic Commissioners of the National Economic Commission (NEC), issued on March 1, 1989, dealt primarily with the opportunities presented by the existence of large and growing surpluses in the Social Security trust funds. We stated that if the administration and Congress could bring about a balanced operating budget, the Social Security surplus would allow us to retire privately held government debt. This would automatically translate into an increase in national savings — perhaps doubling the current savings rate — which offered a means of insuring a strong productive U.S. economy capable of supporting retirees in the next century. We recommended this.

At the same time, Commissioners Strauss, Gray, Iacocca, Kirkland, Rohatyn and myself were explicit in stating that unless this were done, there would be no defensible reason for continuing the payroll tax at present levels, and that Social Security would have to be returned to pay-as-you-go financing as a matter of simple fairness.

***"The bill would strengthen the Social Security system, restore honesty and integrity to our federal finances, and provide a fair tax cut to 132 million Social Security taxpayers."***

The General Accounting Office made the same recommendation in their report, *Social Security: The Trust Fund Accumulation, the Economy, and the Federal Budget,* released January 19, 1989. The GAO suggested:

> If the Congress and the President are unable to agree upon and implement a strategy for restoring fiscal balance in the non-Social Security part of the budget, we believe that the Congress should reconsider the pattern of payroll tax increases that is producing the current and projected social security surpluses. To implement this option, it would be appropriate to return the social security program to a pay-as-you-go financing basis once the social security reserves have reached a desirable contingency level of about 100 to 150 per cent of annual outlays.

As we pointed out in our NEC report, and as was made very clear in the GAO study, the operating budget deficit is not declining. It is growing. The deficit for FY 1989 was $204 billion without the Social Security surplus. The Congressional Budget Office baseline projections show the deficit in the operating budget growing to $268 billion in the year 2000. In that same year the Social Security surplus will be $236 billion. A $268 billion deficit financed almost exclusively by the Social Security payroll tax.

This is totally unacceptable. The tax structure of the United States is fast becoming one of the most regressive of any Western nation. The 1980s have witnessed a decline in the progressivity of federal taxes as a whole — income, payroll, and excise taxes combined — despite improvements made in the Tax Reform Act of 1986. The Social Security Administration reports that of those taxpayers who will pay any Social Security tax in 1990, about 74 percent will pay more FICA taxes — including the employer's share — than in income taxes.

The 1983 decision to move the Social Security trust funds to a partially funded basis was a responsible one. But the only justification there can be for running large Social Security surpluses is to use the surpluses to increase national savings — and thereby provide for higher future productivity and income to support the retirement of the baby boom generation. This was the aim, but we have not achieved it; so the time has come to return Social Security to pay-as-you-go financing.

Social Security was financed on a pay-as-you-go basis for decades prior to 1983. Under this financing method, we schedule Social Security tax rates that will produce the revenue needed for about a year's worth of outlays. We have not had a reserve of a year's worth of benefits since 1970, but under this bill we would have such a reserve at the end of 1990, and at the end of 2065, and at the end of every year in between.

Robert J. Myers, who helped create our Social Security system in 1934 and who for 23 years was its chief actuary, has urged a return to pay-as-you-go financing. In testimony of May 1988 before the Senate Finance Subcommittee on Social Security, Myers stated: "I believe that Social Security should be financed on close to a current cost basis. Income should, on the whole, slightly exceed outgo each year, in order to build up a fund which is about equal to one year's outgo — and certainly no more. This should be accomplished by changing the future tax-rate schedule so as to more nearly match the trend of outgo."

We have tailored our proposal to Mr. Myers' specifications. A Social Security tax rate of 5.1 percent starting in 1991 will be sufficient to finance benefits through 2011 while maintaining a reserve of about a year's worth of benefits. In 2012 the tax rate would rise to 5.6 percent. The legislation schedules a tax rate of 6.2 percent (the current rate) for 2015, 7.0 percent for 2020, and 7.7 percent for 2025. The rate would peak at 8.1 percent for 2045 and later years.

***"Social Security benefits would be even more secure than they are under present law."***

Let me stress that the reserve that would build up under the current law would be exhausted in 2045 in any event, so at that point we would have to go to the same 8.1 percent rate. Also, assuming only modest rates of economic growth between now and 2045, workers at that time will make twice as much in real terms as workers today. Finally, the proposed rise in the rate over the next 55 years is modest compared to the historical rise over the past 55 years. In 1935, the rate was set at 1 percent of the first $3,000 of wages. This has risen, with full public support, to 6.2 percent of the first $51,300 of wages. This is a six-fold increase in the rate over the past 55 years, compared to a 59 percent proposed increase over the next 55 years.

We must end the shameful practice of using Social Security revenues to finance budget deficits. This proposal will restore honesty and integrity to the federal fisc, strengthen the Social Security system, and provide a much-needed tax cut for low and middle-income American workers.

# U.S. Should Put Its Own Tax System in Order Before Fretting over EC92 Rules

**Alan Lipner and Dan Lundy**

*The Ways and Means Committee heard testimony in January to explore and address the implications for U.S. business of EC1992 and an open Eastern Europe. We reproduce here a summary of the testimony given by Mr. Lipner and Mr. Lundy, who testified on behalf of the Tax Council, a business-supported tax policy group.*

We are concerned that harmonization of direct taxes in the EC may ultimately result in adverse consequences for U.S. multinationals, particularly with regard to the potential for increased withholding taxes on funds flowing out of the Community and the removal of local country investment incentives. However, since the development of a comprehensive direct tax harmonization policy is still at a very early stage, these concerns are largely speculative. Of real, immediate import to U.S. business today are not internal EC tax policies, but U.S. tax rules which raise barriers to U.S. competitiveness in the European Community and to overseas business in general. The Tax Council's submission to the Committee identifies the most troublesome of these rules as well as their single unifying characteristic — a severe competitive disadvantage for U.S. multinationals.

***"While tax policies emanating from the European Community and Eastern Europe may ultimately pose competitive problems for U.S. business, the most immediate . . . barriers to U.S. competitiveness in these markets are created by our own tax system."***

Particularly significant to U.S. business are the numerous restrictions on the use of the foreign tax credit and the extension of the current U.S. tax net to active business income of foreign subsidiaries. Neither of these features of the U.S. tax system figure prominently in any European country's scheme of taxing the foreign income of its multinationals.

The most problematic of the U.S. tax rules relating to foreign tax credit utilization are:

- the affiliated group method of allocating interest and other expenses;
- the separate company-by-company limitation for dividends from noncontrolled Sec. 902 corporations;
- the separate limitation for high withholding tax interest;
- the effect of overall domestic losses;
- repeal of the Bon Ami rule; and
- limitations on the alternative minimum tax foreign tax credit.

U.S. business will continue to be harmed by the exercise of quasi-global U.S. taxing jurisdiction, specifically in connection with the following U.S. tax rules:

- the repeal of U.S. tax deferral for active banking, financing and insurance income;
- present law limitations on the "same country" exception under subpart F;
- the extraterritorial application of U.S. life insurance concepts under subpart F;
- limitations on deficit utilization under subpart F;
- the passive foreign investment company provisions, particularly as applied to controlled foreign corporations; and
- the commensurate with income standard for measuring royalties on exported intangibles.

In summary, while tax policies emanating from the European Community and Eastern Europe may ultimately pose competitive problems for U.S. business, the most immediate as well as long-term barriers to U.S. competitiveness in these markets are created by our own tax system.

***Alan Lipner is senior vice president - corporate tax for American Express; Dan Lundy is senior vice president and director of taxes for ITT.***

# Ways and Means Committee Explores Foreign Investment

The House Ways and Means Committee held four days of hearings during the last two weeks of January to examine the growing controversy over whether to restrict direct foreign investment coming into the United States or to promote the free flow of capital across borders.

## Inbound Investment

According to testimony given by Robert F. Hudson, Jr., chairman of the Florida Bar Tax Section, "U.S. tax policy . . . has resulted in perceived and actual discrimination against foreign direct investment in the United States, with the result of diverting potential foreign direct investment either toward U.S. portfolio investments or away from the United States totally."

Specifically, Hudson feels that the system of U.S. income and estate and gift taxation of foreign investors is unfair and that the tax consequences of investing in the United States have scared off the typical individual or family-based foreign direct investor.

***"The U.S. subsidiaries of foreign companies are not, themselves, foreign. . . . They are, for the most part, managed by U.S. citizens and they do not serve foreign political interests."***

— James Merle Carter
Organization for Fair Treatment of International Investment

Hudson explained how the Tax Reform Act of 1986 was the "first clear step in favor of portfolio investment and against direct foreign investment in the United States." Many liberalizations given to U.S. citizens, such as a much higher estate tax credit, are not available to foreign persons.

James Merle Carter, secretary of the Organization for Fair Treatment of International Investment, testified in fa-

***See Hearings on page 4***

*Hearings from page 3*

vor of treating foreign investors in the United States no differently than U.S. investors. He reminded the committee that, "The U.S. subsidiaries of foreign companies are not, themselves, foreign. . . . They are, for the most part, managed by U.S. citizens and they do not serve foreign political interests."

Carter then addressed the concern that foreign investors have an unfair advantage in the United States. He stated that one of the reasons foreign investors are able to put so much money into the American market is the lower cost of capital abroad. He admitted that this is "an area in which many foreign investors have an advantage." However, Carter insisted that the answer is to make U.S. capital more competitive by changing U.S. tax laws so that they do not "make equity more expensive than debt and tax capital gains at the same rate as profits."

## Outbound Investment

Nancy Oliver, director of trade policy for Citizens for a Sound Economy, touched on U.S. tax treatment toward U.S. companies that invest overseas. "The U.S. government taxes at a single rate the worldwide income earned by U.S. companies. As a result, American companies have a harder time competing against foreign companies in countries with a lower corporate tax burden."

***"The U.S. government taxes at a single rate the worldwide income earned by U.S. companies. As a result, American companies have a harder time competing against foreign companies in countries with a lower corporate tax burden."***

— Nancy Oliver
Citizens for a Sound Economy

She added that even though foreign tax credits were designed to reduce double taxation, "the complexity of the system places a huge compliance burden on U.S. companies and inhibits their overseas investments."

QUOTABLE

***"U.S. managers are pretty darn good . . . but captains of industry in the U.S. complain that they can't manage for the long term because they don't have the incentive to do research and development."***

— Jerome Kohlberg, Partner, Kohlberg & Co., testifying March 2, 1990, before the Senate Committee on Banking about the bankrupty of Drexel Burnham Lambert

*Cost of Congress from page 1*

Budget Office, General Accounting Office, and the Architect of the Capitol, each of which has its own budget. These will cost taxpayers $1.2 billion in 1990, 14 percent more than last year.

What does all this money buy? Taxpayers are primarily paying for four things: Congressional leadership, staff and administration; committees and subcommittees; and legislative agency personnel.

***"The legislative branch now employs over 37,600 workers. Congress itself has 19,500 on the payroll — 7,400 in the Senate and 12,100 in the House."***

The U.S. Office of Personnel Management reports that the legislative branch now employs over 37,600 workers. Congress itself has 19,500 on the payroll — 7,400 in the Senate and 12,100 in the House.

Congress's committee system is comprised of 20 committees and 87 subcommittees in the Senate, employing over 770 professional staff, plus 27 committees and 155 subcommittees in the House, with 1,271 professional staff attached. Adding in the joint committees brings the total to over 50 committees and 250 subcommittees in the congressional bureaucracy, paying a professional staff of over 2,100 people.

While this year's $2.3 billion legislative branch spending represents a 10.6 percent increase, 1991 spending is estimated to increase even faster, rising at a 15.6 percent clip for a cost of $2.68 billion. Overall federal spending for the same year is estimated to increase only 3 percent. See details in table above.

### Outlays for the Legislative Branch of the Federal Government by Unit

**Selected Fiscal Years 1970-1990[a]**

**($ Thousands)**

| Unit | 1970 | 1980 | 1989 | 1990 |
|---|---|---|---|---|
| Senate | 57,585 | 183,890 | 347,030 | 385,319 |
| House of Representatives | 108,279 | 324,569 | 549,189 | 571,112 |
| Joint activities | 13,295 | 73,084 | 152,675 | 167,016 |
| Congress, total | 179,159 | 581,543 | 1,048,894 | 1,123,447 |
| Architect of the Capitol | 18,797 | 99,496 | 122,037 | 195,728 |
| Botanic Garden | 620 | 1,583 | 2,502 | 2,680 |
| Congressional Budget Office | - | 12,101 | 17,617 | 19,019 |
| General Accounting Office | 69,857 | 201,192 | 334,811 | 356,703 |
| Government Printing Office | 34,141 | 115,747 | 70,884 | 96,593 |
| Library of Congress | 49,804 | 192,740 | 478,015 | 493,056 |
| Office of Technology Assessment | - | 11,131 | 17,870 | 18,354 |
| U.S. Tax Court | 2,972 | 9,703 | 25,626 | 29,502 |
| Other | - | 13,675 | 2,065 | 5,815 |
| Deductions for offsetting receipts | -12,203 | -10,926 | -26,501 | -24,932 |
| Legislative agencies, total | 163,988 | 636,442 | 1,045,826 | 1,193,498 |
| Total | $ 343,147 | $ 1,217,985 | $ 2,094,720 | $ 2,316,945 |

[a] Data for 1990 are estimates from the FY 1991 Budget presented in January 1990.

Source: Office of Management and Budget.

*Gwendolyn S. King*

# The Social Security System: Safe and Sound For the 21st Century

As Commissioner of Social Security, I am heartened by the current debate on the future financing and continued long-term health of the Social Security program. Such discussions give the American people the chance to learn more about a program that is so important to so many.

Today, Social Security is financially sound. In fact, 1990 marks the 50th anniversary of Social Security's paying benefits, on time and in the right amount, to those who depend on them. And over the next four decades, the Social Security trust fund reserves are projected to grow substantially, ensuring that the program can make good on its commitment to pay monthly benefits to future generations of retirees.

The Bush Administration has a solemn commitment to protect and preserve Social Security. We need to assure its continued solvency and build even greater public confidence in the program. However, I have a unique responsibility as Commissioner to ensure that the current discussion on Social Security edifies, and does not confuse or mislead, the public on America's most important and successful social program. Based on much inaccurate information that has been disseminated to the public recently on this issue, I believe it is necessary to set the record straight on what is fact, and what is fiction.

**Fiction:** Social Security reserves are being used to finance general government operating expenses and, thus, are nothing more than worthless IOUs. They are not being invested for the public's benefit.

**Fact:** Section 201 of the Social Security Act stipulates that Social Security reserves are to be invested exclusively in interest-bearing U.S. government obligations. The law's creators intended that the public's money should be placed in the safest possible investment, backed by the full faith and credit of the U.S. government.

Because Social Security trust funds are invested in Treasury obligations, the money, after investment, has always been available to the government for its general operating needs.

Social Security dollars do draw interest. The Treasury pays the Social Security Trust Fund substantial interest payments — 9.7 percent in the year ending June 30, 1989.

**Fiction:** Social Security reserves are sufficiently high, allowing a payroll tax cut and a return to the pay-as-you-go system.

**Fact:** The 1983 Social Security Rescue Amendments were adopted because of a realization that the pay-as-you-go philosophy left the system vulnerable to the effects of economic downturns. Back-to-back recessions in the late '70's and early '80's moved Social Security dangerously close to fiscal catastrophe. At one point, the contingency reserve contained only 14 percent of the next year's benefit expenditures, necessitating interfund borrowing from the Hospital Insurance Trust Fund.

At the beginning of 1990, the Social Security Trust Fund had accumulated $188 billion. That money represents only nine months' worth of benefit payments. There is general agreement that a contingency of 100-150 percent of the funds needed to pay one year's worth of benefits should accumulate before changes in system financing are even discussed.

**Fiction:** The Social Security payroll tax is a regressive tax.

**Fact:** Social Security provides significant protection to surviving spouses and children, as well as to insured workers and their families in the event of disability. In fact, about 40 percent of Social Security benefit payments are in these non-retirement categories.

The Social Security benefit structure is highly progressive. It provides considerably higher benefits for low earners, in relation to their pre-retirement earnings, than for high-income workers. For workers retiring at age 65, Social Security benefits replace approximately 58 percent of earnings, 42 percent for mid-income Americans and 24 percent for high-income earners.

Today, a low-income worker retiring at age 65 will gain back his or her lifetime Social Security tax contributions, plus interest, in about four years. High-income workers will gain their contribution back with interest in about seven years.

**Fiction:** Currently 74 percent of taxpayers pay more in Social Security payroll tax than they do in federal income tax.

**Fact:** Only 29 percent of those who pay any Social Security tax pay more to Social Security than they pay in federal income tax.

The frequently-quoted 74 percent figure stems from an illogical comparison, weighing the Social Security tax paid by both employer and employee to the income tax paid by workers alone.

**Fiction:** A payroll tax cut is a useful tool to force the government to reduce operating budget deficits without endangering the solvency of Social Security.

**Fact:** A roll-back of Social Security contributions will, in fact, exacerbate the budget deficit by $43 billion in FY 1991 and more in later years. Traditionally, Social Security policy has been shaped and guided solely by the objectives of the Social Security program and the best interests of its beneficiaries. It has not been used as leverage to address other budgetary concerns.

For the long term, the growing Trust Fund reserves, protected from non-Social Security budget demands, would add to the nation's economic prosperity and promote the creation of additional investment capital, goods and services to support retiring workers. Any roll-back of Social Security contributions would pre-empt a necessary build-up in Trust Fund reserves beyond one year's worth of benefit outlays as well as squander a unique opportunity in our nation's history to increase national saving.

***Gwendolyn S. King is Commissioner of the Social Security Administration***

*These opinions are not necessarily those of the Tax Foundation. Editorial replies are encouraged.*

# Congressman Beryl Anthony to Address Tax Foundation R&D Tax Policy Seminar

The Tax Foundation will host a seminar on research and development tax policy on March 22 at the Hyatt Regency on Capitol Hill in Washington, DC. Approaching the theme "R&D Tax Policy: A Study in Conflict – Opportunity for Change," the seminar will set an objective policy debate on sound public and private R&D investment policies for the 1990s. Congressman Beryl Anthony (D-AR), member of the House Ways and Means Committee, will give the keynote address, and other top government, business and academic leaders (see program below) will examine current problems and viable solutions.

## R&D Seminar Program

12:30 **Registration/Light Fare**

1:00 **Keynote Address**
Honorable Beryl F. Anthony
Democratic Congressman - Arkansas
Member, House Ways and Means Committee

1:30 **Issue Overview**
"Outlining the Conflicts in R&D Tax Policy"
John Magee
Partner
Miller & Chevalier

2:15 **Session One**
"Conflict in R&D Tax Policy and the Need for Change"
*Chairman:* Cyrus J. Halpern
Tax Vice President, Federal & International Taxes
AT&T
Edmund K. Harding
Manager of Tax Planning & Litigation
Xerox
Richard A. Grafmeyer
Minority Tax Counsel
Senate Committee on Finance
Stuart E. Eizenstat
Partner
Powell, Goldstein, Frazer & Murphy

3:30 **Break**

3:45 **Session Two**
"Mapping Out Sound R&D Policies for the 1990s"
*Chairman:* M.D. Menssen
Vice President, Taxes
3M
Dr. Anthony Billings
Professor
Wayne State University
Robert N. Mattson
Assistant Treasurer
IBM
Michael J. Graetz
Deputy Assistant Secretary for Tax Policy
Department of the Treasury

5:30 **Cocktail Reception**
*Special guests to be invited from:*
Executive Office of the President
Department of the Treasury
Department of Commerce
Senate Finance Committee
Ways and Means Committee
Joint Committee on Taxation

To register, call 202-863-5454
Media Inquiries: Sedef Onder
All other: Paul Merski

## NOTABLE

- **According to the National Science Foundation, 1989 saw the first real decline in R&D expenditures in 14 years.**
- **FY1991 Budget estimates receipts to increase three times faster than outlays.**
- **Each American's share of the federal debt will increase by $827 in FY1991.**
- **Federal participation in the credit market has increased from 18.4 percent in 1970 to 42 percent in 1989.**


## Tax Features

*Tax Features* (ISSN 0883-1335) is published by the Tax Foundation which operates as a separate unit of Citizens for a Sound Economy Foundation. Original material is not copyrighted and may be reproduced. Please credit Tax Foundation.

Co-Chairman ..... James Q. Riordan
Co-Chairman ..... James C. Miller III
President ..... Wayne Gable
VP, Development & Admin. ..... Dan Witt
Director of Fiscal Affairs ..... Paul Merski
Editor ..... William Ahern

Tax Foundation
470 L'Enfant Plaza, S.W.
Suite 7112
Washington, D.C. 20024
202-863-5454



**Tax Foundation**
**470 L'Enfant Plaza, S.W.**
**East Building, Suite 7112**
**Washington, DC 20024**
**202/863-5454**



THIRD CLASS MAIL
U.S. Postage
**PAID**
Washington, DC
Permit No. 8822


Ms. Jeanne Long
Congressional Info Service
4500 East-West Highway
Bethesda, MD 20814